Office-Supreme Court, U.S.
FILED
MAY 4 1962
JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1961

No. 805

NATHAN HALSMAN, JOSEPH APPLEBAUM, THE APPLEBAUM FOUNDATION, INC., ALFRED N. BARNETT, JULIE A. BUCKLEY, as remaining trustee u w of Daniel Buckley, deceased, PETER FUSARO, HAROLD MALTZ, NORMAN H. RIESER, FRED WEIBERT and REGINA WEIBERT and L. H. LUCKETT, in their own behalf as stockholders of Pantepec Oil Company, C. A., and in behalf of all other such stockholders similarly situated,

Petitioners

against

JOHN W. BUCKLEY, THE CATAWBA CORPORATION and PANTEPEC OIL COMPANY, C. A.,

Respondents

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS JOHN W. BUCKLEY AND THE CATAWBA CORPORATION IN OPPOSITION

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Opinion Below

The opinion of the Court of Appeals for the Second Circuit is set forth in App. A of the Petition.

Jurisdiction

The jurisdictional requisites are adequately set forth in the Petition.

Question Presented

The Court of Appeals for the Second Circuit affirmed the dismissal of Petitioners' derivative action in behalf of Pantepec Oil Company C. A. ("Pantepec"), a Venezuelan Corporation, because it concluded that Venezuelan law was applicable to such an action and that under such law, it is conceded that Petitioners have no claim upon which relief can be granted. Petitioners contend, however, that Venezuelan law is not applicable. The sole question here presented, therefore, is whether, under New York conflict of laws rules, the law of Venezuela governs Petitioners' right to bring this action.

Statement

In affirming the dismissal of the third amended complaint, the Court of Appeals for the Second Circuit concluded that in a stockholders' derivative action brought in behalf of a foreign corporation, the New York Courts, if they assumed jurisdiction at all, would apply the law of the place of incorporation—in this case the law of Venezuela. The Court of Appeals then concluded that under such law Petitioners have no claim upon which relief can be granted, either in their own behalf or in behalf of Pantepec (App. to the Petition, pp. 21-41).

Petitioners contend, however, that the New York Courts would not have applied the law of Venezuela to determine whether they have a claim upon which relief can be granted. Since it is conceded by Petitioners that the complaint does not state a cause of action under the law of Venezuela, the sole question presented is the applicability of Venezuelan law under New York conflict of laws principles.

In support of their application for certiorari, Petitioners urge that:

(1) New York does not follow the rule requiring the application of the law of the place of incorporation in derivative actions;

(2) The "contacts" of the corporate defendant are with New York and this requires application of New York corporate law;

(3) The New York Business Corporation Law requires the application of New York corporate law principles; and

(4) In any event, the law of Venezuela is repugnant to the public policy of New York and would be rejected by the New York Courts.

These points are answered *seriatim* in this brief.

Argument

The issue presented in this case is a narrow one involving the interpretation of the law of the State of New York and no amount of argument can turn it into one justifying review by this Court on a writ of certiorari. The only question here presented is whether the United States Court of Appeals for the Second Circuit correctly interpreted New York conflict of laws principles in holding that New York would apply the law of Venezuela in determining whether or not Petitioners had stated a claim upon which relief could be granted. There is not the slightest doubt that the decision below correctly applied long settled principles of New York conflicts law, and there is no question of New York law requiring decision by this Court.

I

The Decision Below is Clearly Correct.

A

The law of Venezuela governs this action.

The conflict of laws rule applied by the New York courts in cases such as this is settled: In a stockholders' derivative action brought on behalf of a foreign corporation, the Court, if it assumes jurisdiction at all, will apply the law of the place of incorporation—in this case, the law of Venezuela. *Upson* v. *Otis*, 155 F. 2d 606 (2d Cir. 1946); *Russian Reinsurance Co.* v. *Stoddard*, 240 N. Y. 149, 154, 147 N. E. 704 (1925); *German-American Coffee Co.* v. *Diehl*, 216 N. Y. 57, 63-64, 109 N. E. 875 (1915); *Vanderpoel* v. *Gorman*, 140 N. Y. 563, 35 N. E. 932 (1894); *Newman* v.

Baldwin, 13 Misc. 2d 897, 179 N. Y. S. 2d 19 (Spp. Ct. N. Y. Co. 1958); Restatement, *Conflict of Laws*, § 183, Comment (b); *id.* § 194, Comment (a); *id.* § 195; *id.* § 197; *id.* § 199.

The Restatement, *Conflict of Laws*, § 183, Comment (b) (1934) provides as follows:

> "The right of a shareholder to object to conduct occurring in the operation of the corporate enterprise is determined by the law of the state of incorporation. This includes acts that are beyond the purposes of the corporation, acts which are prohibited either by the state of incorporation or by the state where the acts are to be performed and acts which are alleged to be beyond the authority of the officers or directors * * *."

In *Newman* v. *Baldwin*, *supra*, the New York Supreme Court held that the adequacy of a complaint in a stockholders' derivative action was to be tested by the law of the state of incorporation. In that case the defendant moved to dismiss the complaint on the grounds that Delaware law governed, since a Delaware corporation was involved, and that Delaware law required that a demand be made by the stockholders. The New York Court deferred decision on this question awaiting a pending Delaware appeal in a case dealing with the issue of demand. The Delaware case was decided and the New York court held, based on the Delaware determination, that no demand was required under Delaware law. The New York court flatly stated (p. 898): "This Court is of the view that Delaware law governs."

The decision in *Newman* relied in part on *Russian Reinsurance Co.* v. *Stoddard*, *supra*, in which the New York Court of Appeals had stated (p. 154):

> "If the existence of the [foreign] corporation, its capacity to sue, or the authority of its directors to represent it or to bring the action is challenged, we look to the charter and the law of its corporate domicile for the data upon which we may rest our determination of such questions * * *."

And in *Matter of American Fibre Chair Seat Corp.*, 265 N. Y. 416, 193 N. E. 253 (1934), the New York Court of Appeals wrote (p. 420):

> "The stockholders of a corporation may be the real owners of the corporation, but their right to control the corporation is governed by the law of its creation".

Upson v. *Otis*, *supra*, was a stockholder's derivative action brought in the United States District Court for the Southern District of New York by a stockholder of a Delaware corporation against some of its directors. The Court of Appeals for the Second Circuit held that the New York conflict of laws rule required the application of Delaware law, stating (p. 610):

> "Under Erie R. Co. v. Tompkins, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A. L. R. 1487, we must * * * look to New York decisions. It would seem that they follow the usual conflict of laws rule in referring to Delaware 'law' to determine the fiduciary obligations of directors of a Delaware corporation."

It is apparent from the foregoing that Petitioners' claim that the question of New York State law presented is one of "first impression" (Petition, pp. 9, 11), is without any basis. There is, instead, as the Court below held, "a clearly enunciated state rule", requiring the application of Venezuelan law (App. to Petition, p. 37).

B

The "contacts" theory of conflicts has no application here.

In their effort to avoid the unanimity of New York decisions holding that the law of the place of incorporation governs stockholders' actions on behalf of foreign corporations, Petitioners argue that the "center of gravity" or "grouping of contacts" theory applies. Petitioners are in error. The "contacts" theory is inapplicable to actions of this type.

The cases heretofore cited hold, as do all the relevant New York cases, that in a derivative action on behalf of a foreign corporation, the law of the place of incorporation applies. No New York case has applied the "contacts" theory under facts similar to those here presented.

The case cited by petitioners does not support their claim that the "contacts" theory is applicable. In *Auten* v. *Auten*, 308 N. Y. 155, 124 N. E. 2d 99 (1954), the case on which Petitioners principally rely, the New York Court of Appeals carefully limited application of the contacts theory to the facts before it, which were materially different from those involved here.

It is with good reason that the contacts theory has not been applied in New York to stockholder derivative actions. Application in derivative actions of the law of corporate domicile by all courts, regardless of where the action may be tried, has created the certainty which has permitted development of modern corporate enterprise with contacts in many jurisdictions. The rule should not be upset by application of any theory which will give an unpredictable result (see pp. 13-14 hereof).

But even if this Court should choose to apply the contacts theory as enunciated in *Auten*, it is clear on the face of the complaint that all the significant contacts in this case are with Venezuela. No trial is necessary to determine this fact and the District Court was correct in so holding (Petitioners' App. in the Court below, p. 13a).

The relevant Venezuelan contacts disclosed by the record are as follows:

1. Pantepec was created and exists under the law of Venezuela; its primary purpose was and is to engage in the business of producing and selling crude oil and natural gas in Venezuela (Petitioners' App. in the Court below, pp. 66a, 67a).

2. Before the agreement with Phillips Petroleum Company, Pantepec was engaged in the business of producing and selling crude oil and natural gas, principally in Venezuela (Petitioners' App. in the Court below, pp. 66a-78a).

3. By agreement with Phillips Petroleum Company, Pantepec sold to Phillips the oil properties of Pantepec located in Venezuela, reserving to Pantepec in Venezuela (a) an oil payment out of 10% of the production of the Venezuelan properties and (b) royalties on part of the production from new wells which may be drilled by Phillips on Venezuelan properties (Petitioners' App. in the Court below, p. 67a).

Mansfield Hardwood Lumber Co. v. *Jackson*, 268 F. 2d 317 (5th Cir. 1959), cert. denied, 361 U. S. 885 (1960), on which Petitioners rely for their conclusion that the "contacts" theory is here applicable, is plainly not in point.

There, "* * * the only contact point with the incorporating state [was] the naked fact of incorporation" (268 F. 2d at 312). Moreover, *Mansfield* was not even a stockholders' derivative action.

C

The New York Business Corporation Law is not applicable.

Petitioners rely on the New York Business Corporation Law which will become effective on April 1, 1963 to support their argument that the public policy of New York requires the application of New York corporate law to determine the right of Petitioners to maintain this action (Petition, pp. 15-16). However, the sections cited by Petitioners could not, under any circumstances, apply to Pantepec. These sections will apply only to foreign corporations which are authorized to do business, or are actually doing business, in New York. Further, they will apply only if 2/3 or more of the shares of the foreign corporation's stock are owned by residents of New York or if 2/3 or more of the corporate income is allocable to New York for franchise tax purposes. It is not alleged that any of these requirements are met in this case.

The sections cited by Petitioners, therefore, could not apply to this case even if the Business Corporation Law were presently effective.

Moreover, since New York has codified in detail, after long and exhaustive study, those circumstances under which the directors of foreign corporations will be liable under New York law, and since it is apparent that Pantepec does

not fall within the new provisions, the conclusion necessarily follows that even if the New York Business Corporation Law were now in effect, the New York Courts would apply Venezuelan law to the instant action. This is confirmed by the following excerpt from the Report of the Joint Legislative Committee to Study Revision of Corporation Laws, found at p. 31 of McKinney's Business Corporation Law:

> "A new distinction has been drawn between 'domiciled foreign corporations' and other foreign corporations (Sec. 1317). The former, at least two-thirds of whose outstanding shares, or voting shares, are owned by residents of this state or two-thirds of whose business or investment income is allocable to this state, are subjected to the same provisions as domestic corporations in regard to disclosure of financial information and liability and indemnification of officers and directors."

Thus, as to any foreign corporation which is not a "domiciled foreign corporation"—and it is clear that Pantepec is not a "domiciled foreign corporation"—it is the policy of the legislature that the well settled New York rule which requires the application of the law of the place of incorporation continues in force.

D

The law of Venezuela is not repugnant to the public policy of New York.

Petitioners argue that the New York Courts would not apply the law of Venezuela because it is repugnant to the law of the State of New York; they characterize the applicable Venezuelan law as an instrument by which large stockholders may suppress minority stockholders with impunity. In this attempt, Petitioners have allowed themselves to present something less than an accurate description of the Venezuelan law (Petitioners' App. in the Court below, pp. 15a-24a, 147a-165a; Respondents' App. in the Court below, pp. 2a-36a).

Petitioners assert that under the Venezuelan law only holders of 10% or more of the stock of a Venezuelan corporation have any right to lay a complaint before the stockholders' meeting (Petition, pp. 6-7). The fact is that each individual stockholder has the right to be heard at stockholders' meetings and, as a matter of practice, to place his complaint and the basis therefor before the stockholders in advance of the meeting (Petitioners' App. in the Court below, pp. 158a, 162a, 168a; Respondents' App. in the Court below, 15a, 17a).

If a stockholder with a complaint is able to secure the support of 10% of the stockholders, he has the right, as a matter of Venezuelan law, to have the substance of his complaint, and the facts supporting it, presented to the stockholders in advance of the meeting (Petitioners' App. in the Court below, pp. 149a-158a, 188a-199a). Petitioners assert that before this may be done, the complaining stock-

holders must deposit their stock with the comisario* in Venezuela (Petition, pp. 6-7). The fact is that such deposit is not required (Petitioners' App. in the Court below, pp. 156a-157a).

Petitioners now have, and have had during all the years since they brought this action in 1957, ample opportunity within the framework of Venezuelan law to make their grievance known to other stockholders of Pantepec. Their failure to solicit other stockholders cannot be accepted as a demonstration that Venezuelan law "deliberately throttles minority shareholders and leaves them without any practical remedy against managerial fraud" (Petition, pp. 3-4). Although a proxy solicitation might be costly, it would be no more costly than would the same procedure in an American corporation of equal size, and it is difficult to imagine a proxy solicitation which would even approach the cost of this action.

Despite differences in techniques of implementation, the fundamental or underlying policy seems to be the same under the common law of New York and the civil law of Venezuela. Neither gives stockholders the right to sue directly in their own right and each places restraints upon the ability of stockholders to interfere with corporate management: Both attempt, through differing methods, to provide a check on improvident or illegal corporate man-

* The comisario is an official appointed by the stockholders' meeting to watch over management in behalf of all the stockholders (Petitioners' App. in the Court below, p. 150a). His position is regarded with distinction (Respondents' App. in the Court below, p. 157a) and holders of the position jealously guard its integrity (Respondents' App. in the Court below, p. 158a). For failure to discharge his duties with respect to stockholders' complaints, the comisario is civilly liable to the stockholders (Respondents' App. in the Court below, pp. 18a-20a).

agement. Both attempt to protect the financial integrity of the corporate enterprise, and it is unnecessary for the purpose of deciding this case to determine which, if either, system realizes the common aims more effectively.

Furthermore, there is, as the Court below pointed out, nothing to indicate that New York would decline to enforce the law of Massachusetts, which law is similar to the law of Venezuela in that it bars minority stockholders' derivative actions unless an independent majority of stockholders has approved the institution of the action. *S. Solomont & Sons Trust, Inc.* v. *New England Theatres Operating Corp.*, 326 Mass. 99, 93 N. E. 2d 241 (1950); *Pomerantz* v. *Clark*, 101 F. Supp. 341 (D. Mass. 1951); *Carroll* v. *New York, N. Ha. & H. R. R.*, 141 F. Supp. 456 (D. Mass. 1956).

Accordingly, it is plain that Venezuelan law is not repugnant to the public policy of New York. In point of fact, the public policy arguments strongly favor the rule requiring the application of the law of the state of incorporation. Since corporate officers and directors may incur substantial personal liability for corporate decisions which, although undertaken in good faith, later prove to have been improper or illegal, it is extremely important that corporate management be able to evaluate in advance the propriety of corporate action. Any conflict of laws rule which did not afford that certainty would hamstring corporate action in an age in which nearly every large enterprise has international aspects.

Application of the law of the place of incorporation to determine the rights of stockholders, the powers of the corporation or its officers and directors, the nature and extent of the fiduciary obligations of officers and directors

and similar matters, provides a certainty of result which permits intelligent management decision and provides uniform treatment for stockholders of foreign corporations wherever they may be situated.

It is apparent, therefore, that the application of the law of Venezuela in this case is firmly grounded in reason and cannot be said to be repugnant to the public policy of New York.

In any event, in connection with Petitioners' "public policy" argument, the observation of the court below is very much in point (App. to the Petition, pp. 40-41):

> "This Court cannot substitute notions of 'public policy' for well established New York conflict of laws principles, and we are unwilling to conclude that this would be done by New York courts. See Paulsen and Sovern, '*Public Policy*' *in the Conflict of Laws*, 56 Colum. L. Rev. 969 (1956). In this connection we recall the wise admonition of the English judge who said, more than a century ago,
>
> > 'I, for one, protest, * * * against arguing too strongly upon public policy;—it is a very unruly horse, and when once you get astride it you never know where it will carry you. It may lead you from the sound law. It is never argued at all but when other points fail * * *' (Burrough, J.). *Richardson* v. *Mellish*, 2 Bing. 229, 252, 130 Eng. Rep. 294, 303 (1824)."

II.

In any Event, this Case is not a Proper one for Certiorari.

Even if it is assumed—which assumption is contrary to fact—that the law of New York on the issue of whether or not its courts would apply the law of Venezuela to this action is not entirely settled, it is nevertheless plain that this case is not one justifying review on certiorari.

This Court has stated on numerous occasions that when interpreting state law, it will rely on the construction of such law adopted by the lower federal courts because these courts are more familiar with such law. *United States* v. *Durham Lumber Co.*, 363 U. S. 522, 526-7 (1959); *Propper* v. *Clark*, 337 U. S. 472, 486-9 (1948); *Estate of Spiegel* v. *Comm'r*, 335 U. S. 701, 707-8 (1948); *Huddleston* v. *Dwyer*, 322 U. S. 232, 237 (1943).

Thus, in *Huddleston* it was said that (p. 273), "ordinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts". And in *Propper*, this Court wrote that (p. 486), "In dealing with issues of state law * * *, we are hesitant to overrule decisions by federal courts skilled in the law of particular states unless their conclusions are shown to be unreasonable."

Robertson and Kirkham, *Jurisdiction of the Supreme Court of the United States*, p. 650 (1951) declare "certiorari will not issue in diversity cases merely to review

decisions of Courts of Appeals on questions of state law, unless they appear clearly to conflict with those of the state courts."

This is hardly an "exceptional" case or one involving an "unreasonable" decision. Furthermore, even Petitioners do not argue that the decision below is in "conflict" with the decisions of the New York courts.

What then is Petitioners' argument in favor of the granting of certiorari? It is simply that the highest New York Court has not definitively spoken on the issue presented and that the courts below erred in holding that there was, under New York law, a "clearly enunciated rule" (Petition, pp. 9-14).

However, this argument, even assuming its correctness, is not a sufficient reason for issuing a writ of certiorari. Four federal judges, all—Petitioners' argument to the contrary notwithstanding (Petition, p. 12)—skilled in the law of New York, have unanimously held that the New York courts would, if faced with the facts herein presented, apply the law of Venezuela to determine Petitioners' rights. It is submitted, accordingly, that even if the law of New York was not entirely clear, this case would not be a proper one for certiorari in view of the policy of this Court to "leave undisturbed [the] Court of Appeals holding on a question of state law" (*Estate of Spiegel*, p. 708).

Conclusion

For the foregoing reasons, it is submitted that the Petition for a writ of certiorari should be denied.

Respectfully submitted,

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